

No. 10556

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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UNITED NATIONAL CORPORATION, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

OCT 7 - 1943

PAUL P. O'BRIEN,

CLERK



No. 10556

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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UNITED NATIONAL CORPORATION, a corporation,

Petitioner,

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COMMISSIONER OF INTERNAL REVENUE,

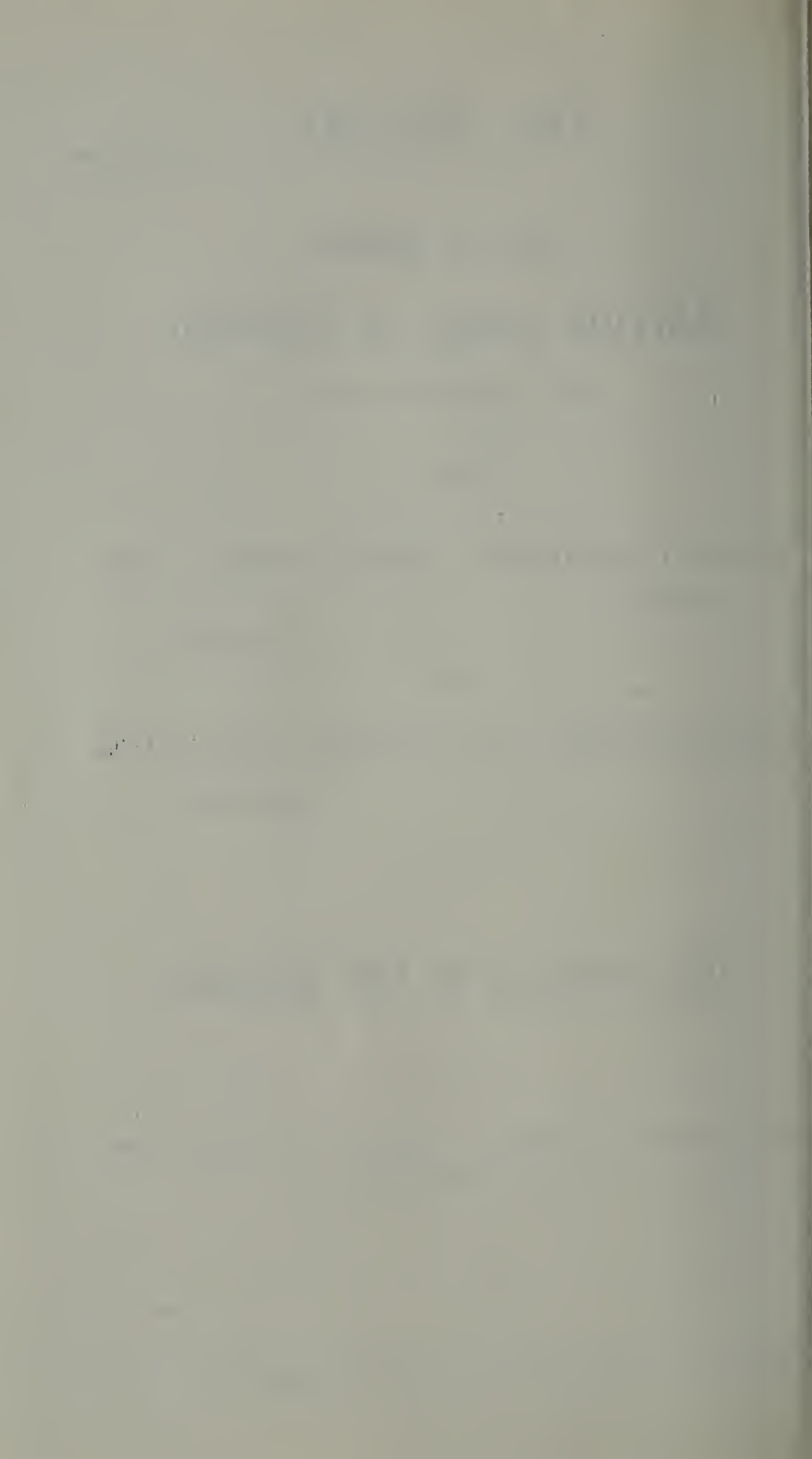
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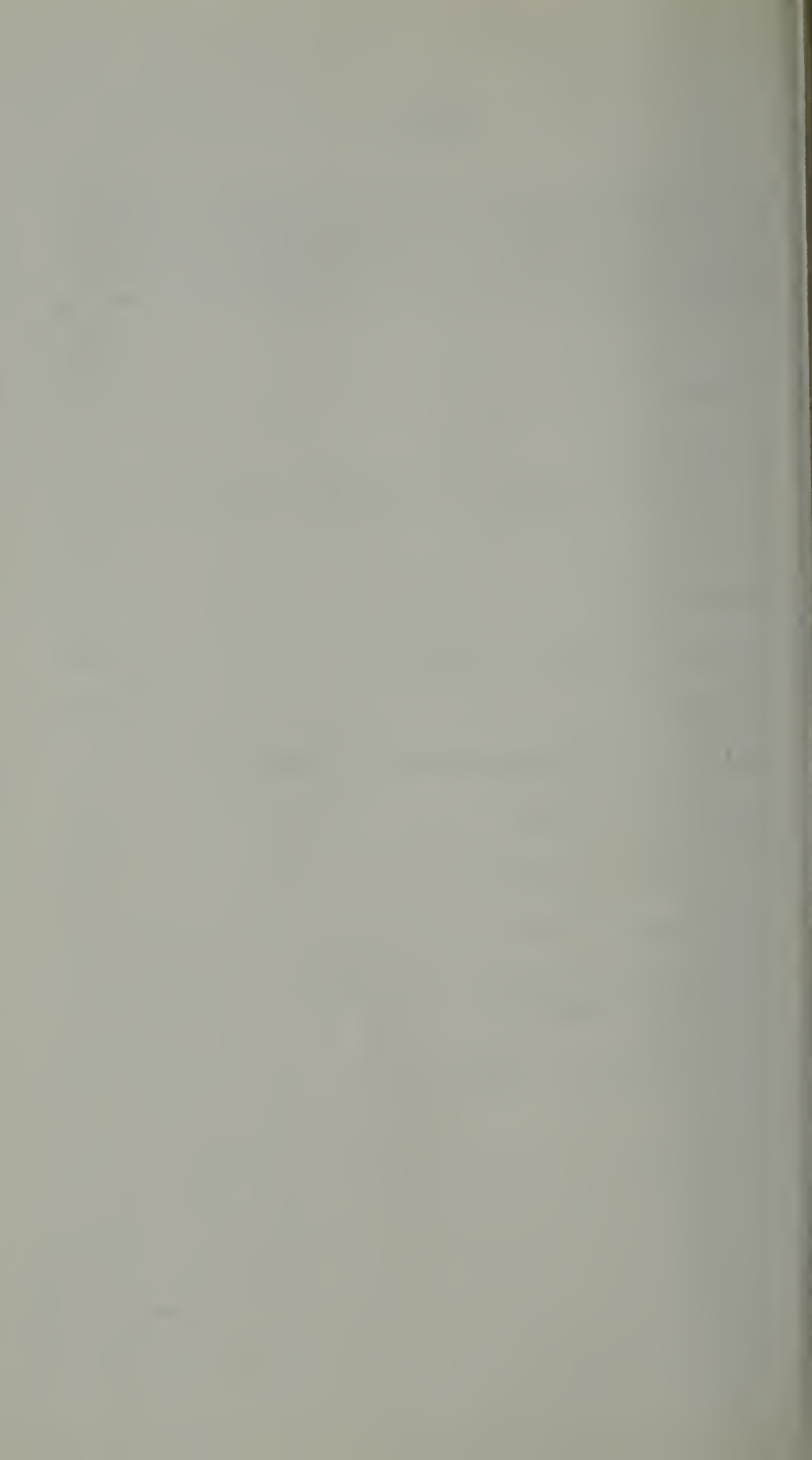


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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

For Taxpayer:

ROGER L. SHIDLER, Esq.

For Comm'r:

B. H. NEBLETT, Esq.,

C. R. MAXWELL, Esq.

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Docket No. 110389

UNITED NATIONAL CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

## DOCKET ENTRIES

1942

Apr. 3—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 4—Copy of petition served on General Counsel.

May 27—Answer filed by General Counsel.

May 27—Request for hearing in Seattle, Wash. filed by General Counsel.

May 29—Notice issued placing proceeding on Seattle, Wash. calendar. Answer and request served.

Aug. 8—Hearing set Sept. 21, 1942 in Seattle, Wash.

Sept. 22—Hearing had before Marion J. Harron on the merits. Submitted.

25—Petitioner's brief due 11-9-42. Respondent's reply brief due Dec. 9, 1942. Petitioner's reply brief due 12-31-42.

Oct. 29—Transcript of hearing Sept. 22 and 25, 1942.

Nov. 9—Brief filed by taxpayer. 11-9-42 Copy served on General Counsel.

1943

Jan. 1—Motion for leave to Jan. 30, 1943 within which to file brief, filed by General Counsel.

Jan. 2—Motion for leave to Jan. 30, 1943 within which to file brief, Granted. Petitioner's reply brief due 2-20-43.

Jan. 30—Brief filed by General Counsel. Served 2-1-43.

Feb. 20—Reply brief filed by taxpayer. 2-20-43 Copy served.

June 15—Findings of fact and opinion rendered, Harron, Judge, Div. 13. Decision will be entered for the respondent. 6-26-43 Copy served.

June 25—Decision entered, Harron, Judge, Div. 13.

Aug. 16—Petition for review by U. S. Circuit Court of Appeals 9th Circuit, with assignments of error filed by taxpayer.

Aug. 17—Proof of service filed by taxpayer.

Aug. 16—Statement of points filed by taxpayer.

Aug. 30—Praeceptum for record filed by taxpayer with proof of service thereon. [1\*]

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\*Page numbering appearing at top of page of original certified Transcript of Record.



United States Board of Tax Appeals

Docket No. 110389

UNITED NATIONAL CORPORATION,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION

1. The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing the symbols IT:90D:JW, dated January 17, 1942, and as a basis of which petitioner alleges as follows:

2. The petitioner, United National Corporation, is a corporation organized and doing business under the laws of the State of Washington, with its principal place of business at Seattle, Washington.

3. The address of the petitioner is 501 Exchange Building, Seattle, Washington.

4. The return for the period involved was filed with the Collector for the District of Washington at Tacoma, Washington. The notice of deficiency, a copy of which is attached hereto, was mailed to the petitioner on January 17, 1942, as the petitioner believes.

5. The taxes in controversy are income taxes for the fiscal year ending June 30, 1939. The deficiency asserted is \$3,224.86. [2] Petitioner asserts that it is entitled to a refund of income taxes erroneously

and illegally collected for the fiscal year ending June 30, 1939, in the sum of \$1,170.27, which sum was paid to the Collector of Internal Revenue for the District of Washington subsequent to September 10, 1939, and within a period of less than three years from the date of filing this Petition. The total amount in controversy is \$4,395.13.

6. The determination of the tax, as set forth in said notice of deficiency, is based upon the following errors:

(a) That the distribution received from Murphey, Favre & Co. during the taxable year, in the sum of \$176,746.55, is essentially equivalent to the distribution of a taxable dividend and is to be treated as such, to the extent of the earnings and profits of that corporation accumulated after February 23, 1913.

(b) That the accumulated earnings and profits of Murphey, Favre & Co. as of September 9, 1938, were in the sum of \$108,509.80, or in any sum greater than \$88,120.80.

(c) That the earnings and profits of Murphey, Favre & Co. as of September 9, 1939, include \$20,389.00, representing increase of surplus resulting from the retirement of preferred stock of Murphey, Favre & Co. at a discount.

(d) In treating that part of the distribution which was properly chargeable to capital account as a distribution of earnings or profits.

7. The facts upon which petitioner relies are as follows:

(a) Prior to September 6, 1938, United National Corporation was the owner of all of the shares of

Murphey, Favre & Co., a [3] Washington corporation, engaged in the investment banking business in Spokane, Washington. Murphey, Favre & Co. had outstanding an authorized capital stock of \$100,000.00, consisting of 1,000 shares of common stock of the par value of \$100.00 per share. As of July 31, 1938, the capitalization of Murphey, Favre & Co., according to its books, was as follows:

Capital stock .....	\$100,000.00
Capital surplus .....	77,410.89
Earned surplus .....	58,251.17
<hr/>	
Total capital surplus and undivided profits .....	\$235,662.06
<hr/> <hr/>	

(b) Prior to September 6, 1938, certain of the officers of Murphey, Favre & Co. entered into negotiations for the purchase of Murphey, Favre & Co. They were unable to raise sufficient funds to purchase the stock of the corporation, on the basis of the capitalization of the company as it existed prior to September 6, 1938. Accordingly, it was agreed by the taxpayer and the prospective purchasers that Murphey, Favre & Co. would reduce its capital stock from 1,000 shares of common stock, of the par value of \$100.00 per share, to 250 shares of common stock, of the par value of \$100.00 per share, and that, upon the surrender of 750 shares of the common stock by the taxpayer, seventy-five per cent (75%) of all of the assets of Murphey, Favre & Co. would be delivered to the taxpayer, as the owner of said 750 shares.

8. Just prior to September 6, 1938, the taxpayer made an offer to Murphey, Favre & Co. to sur-

render for cancellation and retirement 750 shares of the common stock of Murphey, Favre & Co., upon payment to it of the par value of said shares, to-wit: [4] the sum of \$75,000.00, together with \$58,-058.17, being 75% of the paid-in surplus as of July 31, 1938, and \$43,688.38, being 75% of the earned surplus as of July 31, 1938, said sums being the respective amounts attributable to the 750 shares of the common stock to be retired pursuant to the proposed reduction of the capital stock of said corporation.

9. On September 6, 1938, the Board of Directors of Murphey, Favre & Co. adopted the following resolution:

“Now, Therefore, Be It Resolved by the Board of Directors of Murphey, Favre & Co., duly assembled at their special meeting on this 6th day of September, 1938, as follows:

Section 1. That the offer of United National Corporation to surrender 750 shares of common stock of this Corporation, out of the total of 1,000 shares of common stock held by it, for cancellation and retirement, is hereby accepted, and upon the going into effect (a) of the Articles of Amendment, amending Article III of the Articles of Incorporation of this Corporation, so as to provide that the authorized shares of stock of this Corporation shall consist of 250 shares of common stock of the par value of \$100.00 per share, and (b) the Articles of Reduction of Capital Stock of this Corporation, reducing the capital stock of this Corporation from the sum of \$100,000.00 to \$25,000.00, there shall be

paid to United National Corporation, as the holder of said 750 shares of common stock, upon the surrender of said shares to this Corporation for cancellation and retirement, the sum of \$75,000.00, together with \$58,058.17, being 75% of the paid-in surplus as of July 31, 1938, and \$43,688.38, being 75% of the earned surplus of the Corporation as of July 31, 1938, said sums being the respective amounts attributable to the 750 shares of common stock to be surrendered and retired pursuant to the proposed reduction of the capital stock of the Corporation. That as part of said transaction, this Corporation shall deliver to United National Corporation

(a) \$68,800.00 in face amount of Puget Sound Power & Light Company 5½% Notes, due 1940, at a valuation of \$59,326.92, and

(b) 129 shares of Prior Preference Stock of United National Corporation, at a valuation of \$774.00 [5] which property United National Corporation has agreed to accept at said valuations, as part payment of the sum of \$176,746.55, to be paid to it upon surrender of said 750 shares of common stock.

Section 2. The Treasurer of this Corporation is hereby authorized to make payment, in property and cash as aforesaid, to United National Corporation upon the surrender to this Corporation, for cancellation, said 750 shares of common stock of this Corporation, and proper entry shall be made by the Treasurer on the books of this Corporation, charging said



amounts, respectively, to the capital stock account, the paid-in-surplus account, and to the earned surplus account.”

10. Pursuant to a resolution adopted by the Board of Directors of Murphey, Favre & Co. on September 6, 1938, the capital stock of Murphey, Favre & Co. was reduced from 1,000 shares, of the par value of \$100.00 per share, to 250 shares, of the par value of \$100.00 per share. After Articles of Reduction of Capital Stock were filed with the Secretary of State of the State of Washington, distribution was made to United National Corporation, upon the surrender and redemption of said 750 shares of common stock of Murphey, Favre & Co., of a total amount of \$176,746.55, from the assets of Murphey, Favre & Co., representing 75% of (a) capital stock, (b) paid-in surplus, and (c) the earned surplus as shown on the books as of July 31, 1938. Said distribution was made on September 9, 1939.

The amounts received by the taxpayer from Murphey, Favre, & Co., upon the surrender of 750 shares of the common stock of Murphey, Favre & Co., were received in partial liquidation of Murphey, Favre & Co. Pursuant to section 115(c) of the Revenue Act of 1938, the total amount so received from Murphey, Favre & Co. should be applied as against the amount paid for the stock. The [6] cost of the 750 shares to United National Corporation was the sum of \$463,992.75.

11. In its income tax return for the year ending June 30, 1939, the taxpayer erroneously reported

as income \$43,688.38, which amount was part of the \$176,746.55 received from Murphey, Favre & Co. in the partial liquidation of Murphey, Favre & Co. during the taxable year ending June 30, 1939.

12. Prior to June 27, 1932, Murphey, Favre & Co. had outstanding shares of its preferred stock of the par value of \$100.00 per share. During the following fiscal years, respectively, Murphey, Favre & Co. retired shares of its preferred stock at a discount or premium as follows:

June 30, 1929 .....	\$ (30.00) premium
June 30, 1931 .....	19,588.90 discount
June 30, 1932 .....	830.10 discount
<hr/>	
Net total .....	<u>\$20,389.00</u>

The debit or credit was charged or credited to capital surplus on the books of Murphey, Favre & Co. The retirement of said shares was a capital transaction and did not result in any increase or decrease in the earned surplus account of Murphey, Favre & Co. If it be held that all or any part of the \$20,389.00 increase in the surplus account was distributed to the taxpayer as part of the \$176,746.55 received by the taxpayer in connection with the retirement of Murphey, Favre & Co. stock, then said sum was a return of capital to the taxpayer and, as such, did not constitute taxable income.

13. Of the amount of \$176,746.55 distributed in partial liquidation of Murphey, Favre & Co., the sum of \$35,655.95 was [7] properly chargeable to capital account, and pursuant to the provisions of

Sub-section (c) of Section 115 of the Revenue Act of 1938, such sum of \$66,090.60 should not be considered a distribution of earnings or profits.

Wherefore, the petitioner prays that this Board may hear the proceedings and determine that there is no deficiency due from the petitioner for the fiscal year ending June 30, 1939, and that the petitioner is entitled to a refund in the sum of \$1,170.27, on account of taxes illegally collected for the fiscal year ending June 30, 1939.

ROGER L. SHIDLER

Counsel for Petitioner,  
1800 Exchange Building,  
Seattle, Washington.

State of Washington  
County of King—ss.

Ben B. Ehrlichman, being first duly sworn, says: That he is the President of United National Corporation, the petitioner named in the foregoing Petition, and as such is duly authorized to verify the foregoing Petition and is familiar with the statements therein contained, and that the facts therein stated are true.

BEN B. EHRLICHMAN

Subscribed and sworn to before me this 28th day of March, 1942.

[Seal]

HOWARD M. NIMMONS

Notary Public in and for the State of Washington,  
residing at Seattle, Washington. [8]



Treasury Department  
Internal Revenue Service  
Seattle, Washington  
January 17, 1942

Office of  
Int. Rev. Agent  
in charge  
Seattle Division  
350 Federal Office Bldg.  
IT:90D:JW

United National Corporation,  
501 Exchange Building,  
Seattle, Washington.

Sirs:

You are advised that the determination of your income tax liability for the taxable year ended June 30, 1939, discloses a deficiency of \$3,224.86 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Seattle, Washington, for the attention of IT:90D:JW. The signing and filing of this form will expedite the clos-

ing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner

By GEO. C. EARLEY

Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of waiver.

JW:rmt [9]

## STATEMENT

IT:90D:JW

United National Corporation

501 Exchange Building

Seattle, Washington

Tax Liability for the Taxable Year Ended

June 30, 1939

	Liability	Assessed	Deficiency
Income Tax .....	\$4,535.31	\$1,310.45	\$3,224.86

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated March 3, 1941; to your protest dated May 21, 1941; and to the statements made at the conferences held on June 16 and July 7, 1941, and September 15 and October 8, 1941.

A copy of this letter and statement has been mailed to your representative, Mr. Roger L. Shidler, 1800 Exchange Building, Seattle, Washington, in accordance with the authority contained in the power of attorney executed by you.

# ADJUSTMENTS TO NET INCOME

Net income as disclosed by amended return.....	\$ 51,164.80
Unallowable deductions and additional income:	
(a) Dividends from Murphey, Favre & Co.,	
understated .....	64,821.42
Net income adjusted .....	\$115,986.22

[10]

## Explanation of Adjustments

(a) It is held that the amount of \$176,746.55 distributed to you in cash and property during the taxable year by Murphey, Favre & Co., Spokane, Washington, is essentially equivalent to the distribution of a taxable dividend and is to be treated as such to the extent of the earnings and profits of that corporation accumulated after February 28, 1913.

It is further held that the amount of such accumulated earnings and profits to September 9, 1938, the date of the distribution, was \$108,509.80, as follows:

Amount accumulated to June 30, 1938.....	\$109,515.17
Less:	
Reduction from July 1 to September 9, 1938.....	1,005.37
Balance .....	\$108,509.80

There was reported on your return the sum of \$43,688.38 as the amount of dividends taxable, from this source or an understatement of \$64,821.42.

Schedules disclosing the accumulation of the amount of \$109,515.17 from March 1, 1913, to June 30, 1938, are attached as Exhibit A, and Schedules A-1 to A-6, inclusive; accumulation of paid-in surplus, as Exhibit B and a corrected balance sheet as at June 30, 1938, as Exhibit C, are attached hereto.

Included in the amount of \$109,515.17 are items totalling \$20,389.00, representing increase of surplus resulting from the retirement of preferred stock at a discount. Since all of the preferred stock was retired it is held that the distribution of this amount to you as a holder of common stock of taxable.

Your contention that earnings and profits accumulated as at June 30, 1938, should be reduced by book losses for July and August, 1938, has been conceded.

[Endorsed]: U.S.B.T.A. Filed Apr. 3, 1942.

[11]

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[Title of Board and Cause.]

### ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Admits the allegations contained in paragraph 4 of the petition.

5. Admits that the taxes in controversy are income taxes for the fiscal year ending June 30, 1939; that the deficiency asserted is \$3,224.86; and that petitioner asserts that it is entitled to a refund of income taxes for the fiscal year ending June 30, 1939, in the sum of \$1,170.27. For lack of sufficient information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining material allegations contained in paragraph 5 of the petition. [12]

6. Denies that he erred in his determination of the deficiency as shown by the notice of deficiency from which petitioner's appeal is taken. Specifically denies that he erred in the manner and form as alleged in subparagraphs (a) to (d), inclusive, of paragraph 6 of the petition.

7(a). Admits the allegations contained in the first and second sentences of subparagraph (a) of paragraph 7 of the petition. For lack of sufficient information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in said subparagraph (a) of paragraph 7 of the petition.

(b). Admits the allegations contained in subparagraph (b) of paragraph 7 of the petition, except that it is denied that it was agreed between



the taxpayer and the prospective purchasers that seventy-five per cent (75%) of all the assets of Murphey, Favre & Co. would be delivered to the taxpayer.

8. Admits that prior to September 6, 1938, the taxpayer made an offer to Murphey, Favre & Co. to surrender for cancellation and retirement 750 shares of the common stock of Murphey, Favre & Co. For lack of sufficient information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph 8 of the petition.

9. Admits the allegations contained in paragraph 9 of the petition.

10. Admits that pursuant to a resolution adopted by the Board of Directors of Murphey, Favre & Co. on September 6, 1938, the capital stock of Murphey, Favre & Co. was reduced from 1,000 shares, of the par value of \$100.00 per share, to 250 shares, of the par value of \$100.00 per share; [13] that distribution was made to the United National Corporation, upon the surrender and redemption of said 750 shares of common stock of Murphey, Favre & Co., of a total amount of \$176,746.55, from the assets of Murphey, Favre & Co., and that said distribution was made on or about September 9, 1939. Denies the remaining material allegations contained in paragraph 10 of the petition.

11. Admits that in its income tax return for the year ending June 30, 1939, the taxpayer reported as income \$43,688.38, which amount was part of the \$176,746.55, received from Murphey, Favre & Co. during the taxable year ending June 30, 1939.

Denies the remaining allegations contained in paragraph 11 of the petition.

12. Admits that prior to June 27, 1932, Murphey, Favre & Co. had outstanding shares of its preferred stock of the par value of \$100.00 per share, and that during the fiscal years ended June 30, 1929, June 30, 1931, and June 30, 1932, Murphey, Favre & Co. retired said shares of its preferred stock at a discount or premium in the amounts as alleged in paragraph 12 of the petition. For lack of sufficient information upon the basis of which to form a belief as to the truth or falsity thereof, denies the remaining allegations contained in paragraph 12 of the petition.

13. Denies the allegations contained in paragraph 13 of the petition.

14. Denies generally and specifically each and every material allegation contained in the petition herein, not hereinbefore specifically admitted, qualified, or denied. [14]

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination of deficiency be approved.

(Signed) J. P. WENCHEL

J.H.P.

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

Alva C. Baird,

Division Counsel.

John H. Pigg,

Special Attorney,

Bureau of Internal Revenue.

JHP: [Illegible] 5-18-42

[Endorsed]: U.S.B.T.A. Filed May 27, 1942.

[15]

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The Tax Court of the United States

Docket No. 110389

UNITED NATIONAL CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION

Promulgated June 15, 1943

Redemption of common stock in X corporation, which was owned by petitioner, held to be essentially equivalent to the distribution of a taxable dividend within the provisions of section 115 (g) of the Revenue Act of 1938; held, further, that the amount of the earnings or profits of the corporation which made the distribution included the amount of a gain realized in earlier years upon the redemption of all of the preferred stock.



Roger L. Shidler, Esq.,  
for the petitioner,  
B. H. Neblett, Esq., and  
C. R. Maxwell, Esq.,  
for the respondent.

The Commissioner determined a deficiency in income tax for the fiscal year ended June 30, 1939, in the sum of \$3,224.86.

Petitioner contends that there is no deficiency and that it has overpaid tax in the sum of \$1,170.27.

The principal issue is whether certain payments received in 1938 from a corporation in which petitioner was the sole stockholder for shares of its stock were essentially equivalent to the distribution of a taxable dividend under section 115 (g) of the Revenue Act of 1938.

### Findings of Fact

Issue 1.—Petitioner was organized on July 10, 1928, under the laws of the State of Washington. Its principal office is at Seattle, Washington. It filed its return with the collector for the district of Washington. Petitioner keeps its books and files its returns on the accrual basis. Petitioner is a holding company.

During the taxable year, up to September of 1938, petitioner owned all of the stock of Murphey, Favre & Co., consisting of 1,000 shares. The origin of Murphey, Favre & Co. is as follows:

Alonzo M. Murphey, John M. Murphey, and F. D. Gibbs organized a corporation in 1897, known as the Real Estate Trust Co., with 50 shares of \$20

par value stock, all of which was subscribed and paid for in cash by the above persons. In 1912 a corporation, which is called [16] X Co. for convenience, was organized. Its stockholders were Alonzo M. Murphey, Eugene B. Favre, and two others, minor stockholders. Shortly after its organization X Co. acquired all of the assets of Real Estate Trust Co. in exchange for 250 shares of the stock of X Co. However, the stock of X Co. went to the stockholders of the Real Estate Trust Co. In 1914 the Real Estate Trust Co.'s stockholders amended its articles of incorporation so as to change its name to Murphey, Favre & Co., and to increase its capital stock from 50 shares of a par value of \$20 to 500 shares of a par value of \$100. The original 50 shares of \$20 par value were surrendered and canceled. In effect, in 1914, the stockholders of the Real Estate Trust Co. surrendered their stock in that company in exchange for the stock in X Co. which they had received in 1912. Alonzo Murphey was the chief stockholder of the Real Estate Trust Co., owning 48 of the original 50 shares. He held most of the 250 shares of X Co. which had been given in 1912 in exchange for the assets of the Real Estate Trust Co. When, in 1914, the Real Estate Trust Co. was reorganized under the name of Murphey, Favre & Co., it had no assets. It acquired all of the assets of X Co. in exchange for all of its new stock, 500 shares of a par value of \$100. The assets of X Co. were given a value of \$52,500. Accordingly, as of May 1914, Murphey, Favre & Co. had capital of \$50,000

and a paid-in surplus of \$2,500, all of which was represented by assets acquired in exchange for 500 shares of its stock. The X Co. distributed the 500 shares of Murphey, Favre & Co. stock to its own stockholders, Alonzo M. Murphey and Eugene B. Favre, receiving 249 shares each, respectively.

Murphey, Favre & Co. is referred to hereinafter as the Murphey Co.

On December 13, 1921, the Murphey Co. increased its capital stock from \$50,000, divided into 500 shares of common stock at a par value of \$100 per share, to \$100,000, divided into 1,000 shares of common stock of the par value of \$100 per share. The Murphey Co. had net assets at such time as shown by its balance sheet in the sum of \$123,700, consisting (prior to said increase) of unimpaired capital stock in the sum of \$50,000 and of surplus and undivided profits in the sum of \$73,700. The additional 500 shares of common stock of the par value of \$100 per share were issued to the stockholders of the Murphey Co. as a stock dividend at the rate of one share thereof for each share of the old common stock. The said sum of \$50,000 was transferred from surplus and undivided profits to capital stock account in full payment of the 500 additional shares distributed as a stock dividend.

On March 2, 1927, the capital stock of the Murphey Co. was increased from \$100,000, divided into 1,000 shares of common stock of the par value of \$100 per share, to \$190,000, divided into 1,500 shares of common stock of the par value of \$100 per share and 400 shares of pre [17] ferred stock

of the par value of \$100 per share. The Murphey Co. had net assets at such time as shown by its books of account in the sum of \$134,244.80, consisting (prior to said increase) of unimpaired capital stock in the sum of \$100,000 and surplus and undivided profits in the sum of \$34,244.80. The 400 shares of preferred stock were purchased by a stockholder of the Murphey Co. Of the 500 shares of common stock authorized to be issued, 250 shares were issued ratably as a stock dividend to the stockholders of the Murphey Co. in the ratio of one share of common stock for each four shares of the old common stock. The sum of \$25,000 was charged against the then existing surplus and undivided profits of the Murphey Co. and transferred to the capital stock account of the Murphey Co., in full payment of the total par value of \$25,000 of said 250 new shares of common stock so issued as a stock dividend. The stockholders of the Murphey Co. at the time purchased from it for cash the balance of 250 shares of said additional 500 shares of common stock, at the price of \$100 per share, and all of the additional 500 shares of common stock were accordingly issued as nonassessable stock of the Murphey Co.

On August 9, 1928, the capital stock of the Murphey Co. was further increased from \$190,000, divided into 1,500 shares of common stock of a par value of \$100 per share and 400 shares of preferred stock of a par value of \$100 per share, to \$450,000, divided into 2,000 shares of common stock of the par

value of \$100 per share and 2,500 shares of preferred stock of the par value of \$100 per share. The additional 500 shares of common stock were sold at the cash price of \$100 per share. There were issued 2,335 shares of the preferred stock for a total consideration of \$233,500.

Between September 1, 1928, and June 27, 1932, all of the issued preferred stock of the Murphey Co. was retired and canceled.

In December 1928 the petitioner acquired 2,000 shares of common stock of the Murphey Co. by purchase from the then stockholders, by delivering and transferring to them 21,333 shares of its own participating preference stock. On June 4, 1932, the 2,000 shares of common stock were reduced to 1,000 shares, the certificates representing 2,000 shares were surrendered, and new certificates for 1,000 shares were issued by the Murphey Co. No distribution of assets was made to shareholders in connection with the exchange. On June 27, 1932, the total outstanding stock of the Murphey Co. comprised the above 1,000 shares, and petitioner was the sole stockholder.

Prior to September 6, 1938, some of the officers of the Murphey Co., acting as individuals, entered into negotiations with petitioner for the purchase of all of the 1,000 shares of stock. They were unable to raise sufficient funds to purchase the entire block of stock on the basis of the capitalization of the Murphey Co. at that time. [18]

At a special meeting of the stockholders of the Murphey Co., which was held on September 6, 1938,



a resolution was adopted to amend the articles of incorporation so that the authorized capital stock should be 250 shares of common stock of the par value of \$100. This amendment of the charter of the Murphey Co. was for the purpose of reducing the capital stock from 1,000 shares to 250 shares, and it was contemplated that 750 shares of the total 1,000 shares outstanding would be surrendered for cancellation and retirement.

On September 6, 1938, at a special meeting of the directors of the Murphey Co., resolutions were adopted and approved, amending the charter to reduce the authorized capital stock to 250 shares of common stock. Also at this meeting a resolution was adopted which provided as follows:

That the offer of United National Corporation to surrender 750 shares of common stock of this Corporation [Murphey Co.], out of the total of 1,000 shares of common stock held by it, for cancellation and retirement, is hereby accepted, and \* \* \* there shall be paid to United National Corporation, as the holder of said 750 shares of common stock, upon the surrender of said shares to this Corporation for cancellation and retirement, the sum of \$75,000.00, together with \$58,058.17, being 75% of the paid-in surplus as of July 31, 1938, and \$43, 688.38, being 75% of the earned surplus of the Corporation as of July 31, 1938. said sums being the respective amounts attributable to the 750 shares of common stock to be surrendered and retired pursuant to the proposed reduction of the capital stock

of the Corporation. That as part of said transaction, this Corporation shall deliver to United National Corporation

(a) \$68,000.00 in face amount of Puget Sound Power & Light Company 5½% Notes, due 1940, at a valuation of \$59,326.92, and

(b) 129 shares of Prior Preference Stock of United National Corporation, at a valuation of \$774.00

which property United National Corporation has agreed to accept at said valuations, as part payment of the sum of \$176,746.25, to be paid to it upon surrender of said 750 shares of common stock.

The Treasurer of this Corporation is hereby authorized to make payment, in property and cash as aforesaid, to United National Corporation upon the surrender to this Corporation, for cancellation, said 750 shares of common stock of this Corporation, and proper entry shall be made by the Treasurer on the books of this Corporation, charging said amounts, respectively, to the capital stock account, the paid-in surplus account, and to the earned surplus account.

The offer of petitioner referred to above had been authorized at the meeting of the officers of the directors of petitioner which was held on August 31, 1938, at which meeting a resolution was adopted authorizing petitioner's treasurer to deliver 750 shares of common stock of the Murphey Co. to the treasurer of the Murphey Co. for cancellation and retirement upon the going into effect of the pro-

posed amendment to the articles of incorporation of the Murphey Co. It was recited in the minutes of the meeting held August 31, 1938, that it was proposed to surrender for cancellation and retirement 750 shares of the common [19] stock of the Murphey Co. and that there should be paid to petitioner "the sum of \$75,000, being 75 per cent of the capital stock of the Corporation, together with \$58,058.17, being 75 per cent of its paid-in surplus as of July 31, 1938, and \$43,688.38, being 75 per cent of its earned surplus as of July 31, 1938," and that it was also proposed that petitioner should accept from the Murphey Co., as part payment of the above sums which would become due to it, Puget Sound 5½ percent notes, at a valuation of \$59,326.92, and 129 shares of petitioner's own prior preference stock.

On September 6, 1938, the capital stock of the Murphey Co. was reduced from 1,000 shares to 250 shares of the same par value of \$100 per share. After articles of reduction of capital stock were filed with the Secretary of State of the State of Washington, distribution was made to petitioner upon the *surrender* and redemption of 750 shares of common stock of the Murphey Co. of a total amount of \$176,746.55 from the assets of the Murphey Co., of which \$116,645.63 was paid in cash and \$60,100.92 was paid in securities of an agreed value of that amount.

After the redemption was effected and on September 16, 1938, the petitioner sold the remaining 250 shares to certain of the officers of the Murphey



Co. for \$51,835.16. Prior to this, however, on September 15, 1938, petitioner entered into a contract with the Murphey Co. whereby petitioner agreed to advise the Murphey Co. in the conduct of its business for a percentage of its annual profits but not to exceed the sum of \$75,000 over a period of 10 years.

From March 1, 1913, to June 30, 1938, the taxable and nontaxable income of the Murphey Co., as shown by its income tax returns, aggregated \$608,153.50; net additional taxable income resulting from audit reviews of returns aggregated \$1,748.09; and additional nontaxable profit because of retirement of preferred stock at a discount amounted to \$20,389; total \$630,290.59. During this period the Murphey Co. paid cash dividends aggregating \$416,192.56; paid income taxes aggregating \$86,612.21; paid insurance premiums aggregating \$10,856.47; made donations of \$7,114.18; total \$520,775.42. The earnings and profits accumulated by the Murphey Co. during this period were \$109,515.17, adjusted for certain items of \$1,005.37, as agreed to by the parties, to \$108,509.80.

As of June 30, 1938, the paid-in capital, the paid-in surplus, and the earned surplus of the Murphey Co., were as follows:

Capital paid-in for stock .....	\$125,000.00
Paid-in surplus—cash paid in .....	47,400.00
Earned surplus, adjusted .....	108,509.80

There was no intention on the part of the shareholders and officers of the Murphey Co. to curtail the company's business operations at the time of

the distribution of September 1938 upon the redemption of 750 [20] shares of common stock. In fact, the Murphey Co. intended to do a larger business in the future than it had in the past. The Murphey Co. had never had, at any time, the intention of liquidating its business or winding up its affairs.

The purpose of reducing the common stock of the Murphey Co., from 1,000 shares to 250 shares was to accommodate its sole stockholder, petitioner, which desired to sell all of its holdings in the Murphey Co., and to distribute a portion of the accumulated earnings and profits to its sole stockholder. The distribution during 1939 by the Murphey Co., upon cancellation of 750 shares of its stock, was essentially equivalent to the distribution of a taxable dividend within the meaning of section 115 (g) of the Revenue Act of 1938.

Issue 2.—On June 30, 1929, the Murphey Co. redeemed shares of its preferred stock at a premium over par value in the total amount of \$30. On June 30, 1931, the Murphey Co. redeemed shares of its preferred stock at a discount from the par value of the shares in a total amount of \$19,558.90. On June 30, 1932, the Murphey Co. redeemed shares of its preferred stock at a discount from the par value of the shares in the total amount of \$830.10. All of the above redemptions were at a net discount of \$20,389. Upon redemption said shares were canceled or retired. The Murphey Co. never traded in its own stock by buying from one customer and selling to another. It is stipulated between the parties that if the Court finds that the sum of \$20,389 rep-

representing the net discount on the redemption of the preferred stock is part of the accumulated earnings or profits of the petitioner, then the amount of the accumulated earnings or profits of the Murphey Co. from February 28, 1913, to September 9, 1938, was \$108,509.80; and if the said sum of \$20,389 is not a part of the accumulated earnings or profits of the Murphey Co., then the amount of the accumulated earnings or profits to September 9, 1938, was \$88,-120.80 (the difference being \$20,389.)

Beginning with the year 1920, the business of the Murphey Co., in line with other investment companies, began to expand. It was for this reason that in 1928 preferred stock was issued. However, its zenith was reached in 1929, and thereafter during the early 1930's the business substantially decreased. As a result, all of the preferred stock was retired before and during 1932. By 1938 the business was substantially greater than in 1934.

The inventories of securities carried by the Murphey Co., as far as the record shows, were as follows:

Fiscal year ended	Amount	Fiscal year ended	Amount
1928 .....	\$485,703.20	1934 .....	\$ 60,649.69
1929 .....	776,930.72	1938 .....	183,511.49
1933 .....	90,730.49	1939 .....	379,473.79

[21]

The gain of \$20,389 realized by the Murphey Co. upon the redemption of all of its preferred stock is a part of its accumulated earnings or profits, which amounted to \$108,509.80 in September 1938.

## OPINION

Harron, Judge: The Commissioner determined a deficiency of \$3,224.86, in petitioner's income tax for the fiscal year ended June 30, 1939, by applying section 115 (g) of the revenue Act of 1938<sup>1</sup> to the redemption and cancellation of 75 percent of the common capital stock of Murphey, Favre & Co. (the Murphey Co.) owned by petitioner, which owned 100 percent of the stock of that company, and thus taxing a part of the amount received by petitioner as an ordinary dividend.

There was distributed to petitioner by the Murphey Co. the sum of \$176,746.56, in cash and property, upon the surrender of 750 shares of the stock of that company. It had been agreed by the respective officers of the Murphey Co. and petitioner that the distribution should be made in securities having a total value of \$60,100.92, and in cash in the amount of \$116,645.63; and that the source of part of the cash was to be 75 percent of the total paid-in surplus and 75 percent of the total earned sur-

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<sup>1</sup>Sec. 115. Distribution by Corporations.

\* \* \* \* \*

(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend—at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

plus, as of July 31, 1938, or, \$58,058.17 from paid-in surplus and \$43,688.38 from earned surplus.

In its income tax return for the fiscal year ending in 1939, petitioner included \$43,688.38 in its gross income as income from dividends from Murphey Co. That amount represented 75 percent of the earned surplus of the Murphey Co. as of July 31, 1938, which petitioner had received as part of the distribution in September 1938, according to the understanding of the parties to the transaction. In determining the deficiency respondent increased the dividends received from the Murphey Co. by \$64,-821.42, his determination being that the distribution was a taxable dividend to the extent of earnings or profits accumulated after February 28, 1913, and that the total of adjusted accumulated earnings or profits after February 28, 1913, was \$108,509.80 as of the date of the distribution.

In its petition to this court petitioner alleged that it erred in including the sum of \$43,688.38 in income and, as a result, overpaid income tax in the amount of \$1,170.27.

The first question is whether the distribution from the Murphey Co. to petitioner on September 9, 1938, upon the surrender for cancellation [22] of 750 shares of Murphey Co. stock, was made at such time and under such conditions as to make the distribution and cancellation or redemption, in whole or in part, essentially equivalent to the distribution of a taxable dividend, within the meaning of section 115 (g).



In the event the first question is decided against petitioner, a second question is to be considered which relates to the amount of the distribution which is to be treated as a taxable dividend under section 115 (g). The parties have stipulated that the amount of the earnings or profits of the Murphey Co. accumulated after February 28, 1913, up to the time of the distribution to petitioner in cancellation or redemption of its stock in Murphey, is \$108,509.80, including a net profit of \$20,389 realized by Murphey upon cancellation and retirement of all of its preferred stock prior to the taxable year. The second question is whether \$20,389 should be regarded as part of the accumulated earnings or profits of the Murphey Co. for the purpose of section 115 (g) in this proceeding, being petitioner's contention that the redemption of the preferred stock was a capital transaction and that any profit realized by the Murphey Co. thereon does not increase its accumulated earnings or profits after February 28, 1913. Petitioner contends that for the purpose of section 115 (g), if it is applied in this case, the accumulated earnings of the Murphey Co. did not exceed \$88,120.80. Respondent takes the opposite view, contending that the above profit increased the accumulated earnings or profits to \$108,509.80.

Issue 1.—Petitioner contends that section 115 (g) does not apply, and the entire amount of \$176,746.55 received by virtue of the redemption of 750 shares of Murphey Co. stock was a distribution in

partial liquidation covered by section 115 (c),<sup>2</sup> and that, since it was no more than the cost of the stock redeemed, there is nothing to tax. Petitioner admits that the redemption of the 750 shares of the Murphey Co. stock was to enable petitioner to sell all of the common stock of the Murphey Co.

Respondent contends that the distribution in question did not have any of the characteristics of a dividend in partial liquidation, citing, *Rheinstrom v. Conner*, 33 Fed. Supp. 917; *affd.*, 125 Fed. (2d) 790; *certiorari denied*, 317 U. S. 654; *rehearing denied*, 317 U. S. 708; [23] that there was no thought on the part of the officers of the Murphey Co. at the time of the distribution to liquidate its business, citing, *McGuire v. Commissioner*, 84 Fed. (2d) 431; *certiorari denied*, 299 U. S. 591; *W. & K. Holding*

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<sup>2</sup>Sec 115. Distributions By Corporations.

\* \* \* \* \*

(c) Distributions In Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. \* \* \* In the case of amounts distributed (whether before January 1, 1938, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. \* \* \*

Corporation, 38 B. T. A. 830; and that the time at which and the manner in which the redemption of Murphey Co. stock was made were such that the redemption effected a distribution of earnings or profits, citing *George Hyman*, 28 B. T. A. 1231; *affd.*, 71 Fed. (2d) 342; *certiorari denied*, 293 U. S. 570; *William H. Grimditch*, 37 B. T. A. 402; and *E. M. Peet*, 43 B. T. A. 852.

The facts, in many respects, are similar to the facts in *George Hyman*, *supra*. Here, as in the *Hyman* case, petitioner was the sole stockholder of a corporation which had a substantial surplus as of July 31, 1938. Petitioner, by causing the Murphey Co. to cancel 75 percent of its stock on the basis of par plus 75 percent of paid-in surplus and 75 percent of earned surplus, received an amount greater than the adjusted earned surplus of \$108,509.80. The same effect resulted in the distribution in the *Hyman* case, and what was said there, at page 1233 of the report of the Board of Tax Appeals, may be said here, appropriately, with slight modification to fit the facts in this case, to wit: Thus, as to the amount of the surplus of the Murphey Co., petitioner was in no different situation from what it would have been in had there been an ordinary dividend; and the only difference to the Murphey Co., is that it had a reduced capital, which, after the distribution, was represented by an outstanding 250 shares instead of 1,000. "From such facts it is just as conceivable that the redemption and cancellation were essentially equivalent to a dividend as it is that they were not; and, since the respondent has



determined that they were and the burden of proof is on petitioner, we cannot affirmatively find that it was not."

There is little evidence relating to the business activities of the Murphey Co. The testimony of its secretary-treasurer was limited and general on this subject. He testified that the volume of business decreased after 1932. The evidence shows that the inventories of the Murphey Co. increased from \$485,703 at the end of 1928 to \$776,930.72 at the end of 1929. In August of 1928 capital was increased from \$190,000 to \$450,000, and part of the increase consisted of 2,335 shares of preferred stock which were issued for \$233,500 in cash. In 1931 and 1932 all of the preferred stock was redeemed, so that the capital of the Murphey Co. was reduced by approximately \$200,000. Also, in June 1932 the authorized common stock was reduced from 2,000 shares to 1,000 shares. The books of the Murphey Co. were not produced at the trial, and the evidence does not show the reason for this reduction or what adjustments were made on the books after the reduction. Lacking evidence, it must be assumed that the reduction [24] of the common stock reduced book capital by \$100,000 and increased book accumulated earnings by \$100,000. We think the above is evidence that the Murphey Co. had substantially adjusted its capital downward by the end of 1932 in harmony with its decrease in business and the decrease in its need for capital. A legitimate business reason for increasing the capital stock of a corporation is found in the need for acquiring capital to

carry on increased business, and, correspondingly, a decrease in business will provide a business reason for reducing capital stock.

The existence of a substantial amount of accumulated undivided profits or earnings available for the payment of dividends, at a time when there is a distribution upon a redemption of stock, invites close scrutiny of the distribution. Part of petitioner's burden of proof is to show that the redemption of the stock in 1938 was not a cloak for the distribution of taxable dividends. In this case the record contains testimony that in September 1938 the Murphey Co. did not need as much as it had in the past to carry its inventory. One interpretation to put upon such evidence is that the business needs of the Murphey Co. did not require retention of the very substantial accumulation of earnings and profits, and business conditions were such that a declaration and distribution of a dividend would have been within the lines of good management. Petitioner has failed to introduce evidence, under its burden of proof, to show that the retirement of 750 shares was intended to be for Murphey's business purposes. On the other hand, the resolution of the directors of the Murphey Co. adopted at the meeting of September 6, 1938, clearly evidences an intent to distribute 75 percent of the accumulated earnings. This intent could have been carried out by declaring and distributing a dividend of 75 percent of accumulated earnings. The Murphey Co. did not declare dividends for its fiscal year ended June

30, 1938, and there is no evidence to show that it did in the fiscal year 1939.

Eugene B. Favre, an officer and director of the Murphey Co., and others associated with the company wished to purchase petitioner's holdings in the Murphey Co. for about \$50,000. Favre was also a director of petitioner. The plan which was adopted to carry out the proposed transaction between petitioner and Favre and his group accomplished two things, a distribution to petitioner of part of the net worth of the Murphey Co. and the exclusion of petitioner as a stockholder. When the entire transaction was completed petitioner had received a total of \$228,581.72, but all that the vendees paid for petitioner's stock was \$51,835.16. The redemption of 750 shares of Murphey Co. stock was a step in the plan under which the capital stock was reduced from 1,000 shares to 250 shares. The redemption served to distribute part of the earnings to petitioner without a dec- [25] laration of a dividend, although petitioner could have caused the Murphey Co. to declare a dividend. The entire plan enabled petitioner to receive 75 percent of the net worth of the Murphey Co. and to sell the remaining 25 percent for a price which the vendees could pay.

It is conceivable that a plan of this sort to change the ownership of a corporation could have a real business advantage to the corporation, itself, for a change in management, incident to a change in ownership could be necessary, advantageous, and conducive to the better conduct of business. But there is no evidence that such purposes were the reason for

the plan for the change in ownership of the Murphey Co. Cf., *Bona Allen, Jr.*, 41 B. T. A. 206. Petitioner cites the Allen case as authority to support its contention that the reduction in the capital stock of the Murphey Co. served a business purpose so as to take the transaction out of the scope of section 115 (g). But the facts in the Allen case do not resemble the facts here in any way. There, stock was redeemed at par in satisfaction of debts of stockholders to the corporation. It was necessary that such debts be reduced to improve the credit standing of the corporation. Also, the corporation needed to retain its cash in the conduct of its business, and the business requirements of the corporation did not permit a distribution of a dividend.

None of the officers of the Murphey Co. were called by petitioner as witnesses. The failure of petitioner to introduce evidence to show a business purpose from the standpoint of the Murphey Co., itself, makes it difficult, if not impossible, to reverse respondent's determination. Also, the reduction in the stock appears to have been initiated by petitioner for the purpose of facilitating the sale of all of petitioner's interest in the Murphey Co. for about \$50,000 and, at the same time, to enable petitioner to receive 75 percent of the net worth of the company. Such does not in itself evidence a business purpose to the corporation affected. The entire plan was to accommodate petitioner and the vendees, and the circumstances were such that the conduct and operation of the business of the Murphey Co. was not affected. The business of the Murphey Co. did



not decrease as a result of the distribution upon the redemption of the stock. It went on profitably after the transaction just as it had prior to the whole transaction. The decrease in stock has not been shown to have been related to any decrease in the business of the Murphey Co. In fact, its business was greater in its fiscal year ended June 30, 1939, the year in which the redemption took place, than it was in the preceding fiscal year.

Under section 115 (g) the effect of the redemption is of the greatest importance, and it is not determinative of a question arising under that section whether the stock redeemed was or was not issued as a stock dividend. *Flanagan v. Helvering*, 116 Fed. (2d) 937; *Smith v. United [26] States*, 121 Fed. (2d) 692. No doubt some weight should be given to the fact that out of the total issued common stock (2,000 shares before the reduction to 1,000 shares in October 1929), 750 shares were issued as stock dividends, resulting in the capitalization of \$75,000 of earnings and profits. Thus 37½ percent of the outstanding stock represented corporate profits. However, we do not rest our conclusion solely upon this fact because of the reduction in stock which took place in October 1929, under which, presumably, \$100,000 was transferred from capital to earnings, and neither party has enlightened us with respect to the significance of that reduction of stock. The applicability of section 115 (g) is unaffected by whether the stock redeemed was or was not issued as a stock dividend. See *Vesper Co. v. Commissioner*, 131 Fed. (2d) 200.

It was provided in the written resolution that the entire distribution in the amount of \$176,746.56 should include an amount representing 75 per cent of earned surplus as of July 31, 1938. Thus, those in control of the Murphey Co. and representing the petitioner in this case themselves recognized that the distribution was in part the equivalent to the distribution of a taxable dividend. The petitioner even reported this amount in its return as a taxable dividend. Section 115 (g) provides that if the cancellation or redemption "in part" is essentially equivalent to the distribution of a taxable dividend, then the amount so distributed to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. The amount which the written resolution recognized as earnings was an incorrect amount. The parties have stipulated the amount of accumulated earnings available at the time. Therefore, following section 115 (g), that amount is to be treated as a taxable dividend.

The ratio decidendi in *Hyman v. Helvering*, 71 Fed. (2d) 342, fits the facts of this case exactly. That reasoning need not be repeated here, but to it reference is made. In our opinion this case is controlled by the *Hyman* case.

It is held that petitioner has failed to overcome the prima facie correctness of respondent's determination that section 115 (g) applies to the distribution in question, and that the amount distributed shall be treated as a taxable dividend to the extent of the accumulated earnings and profits.



Petitioner relies on *Parker v. United States*, 88 Fed. (2d) 907, which held that section 115 (g) can not cover redemption payments made to an intervening purchaser for value. In our opinion the *Parker* case is not applicable here in view of the many factors present here which were not present in that case. See *Flanagan v. Helvering*, *supra*, where the court did not consider the *Parker* case applicable. [27]

We have here a distribution between two domestic corporations. In *Salt Lake Hardware Co.*, 27 B. T. A. 482, which decided a question arising under the Revenue Act of 1926, it was said that section 201 (g) of the 1926 Act, which corresponds to section 115 (g) of the 1938 Act, could not apply to distributions between corporations which are non-taxable. Here the distributee was a holding company and taxable upon dividends from a domestic corporation. What was said in *Salt Lake Hardware Co.*, *supra*, has no application here.

Issue 2.—The second issue relates to the amount of the accumulated earnings of the *Murphey Co.* for the purpose of applying section 115 (g) in this case. The *Murphey Co.* realized a gain of \$20,389 upon the redemption of all of its preferred stock. Of course that gain was not a taxable gain. But we think it must be considered as constituting part of the “earnings or profits accumulated after February 28, 1913.” In *R. N. Weyerhaeuser*, 33 B. T. A. 594, 597, it was stated that many items such as interest upon the obligations of a state and dividends from other corporations “must necessarily be con-

sidered in computing earnings and profits, though forming no part of taxable net income." In *Charles F. Ayer*, 12 B. T. A. 284, 287, it was pointed out that the earnings or profits mentioned in section 201 (a) of the Revenue Act of 1921 (which corresponds to section 115 (a) of the Revenue Act of 1938 and of the Internal Revenue Code) are not the equivalent of the taxable net income of a corporation. It may be said here that "earnings or profits" referred to in section 115 (g) are the same as are referred to in section 115 (a), the latter section being somewhat redundant.

The tax free profit realized upon the redemption of the preferred stock is taxable to a stockholder upon distribution, just as tax free interest on exempt bonds is part of earnings and profits and may form part of ordinary dividends which are taxable when received by stockholders. Under the reasoning of *Charles F. Ayer*, *supra*, respondent's determination that the accumulated earnings or profits of the *Murphey Co.* includes the profit from the redemption of the preferred stock is sustained. For the purpose of section 115 (g), as applied here, the accumulated earnings or profits of the *Murphey Co.* amounted to \$108,509.80.

**Decision** will be entered for the respondent. [28]

The Tax Court of the United States  
Washington

Docket No. 110389

UNITED NATIONAL CORPORATION,  
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion promulgated June 15, 1943, it is

Ordered and Decided: That there is a deficiency in income tax for the fiscal year ended June 30, 1939 in the amount of \$3,324.65.

(Signed) MARION J. HARRON  
Judge.

(Seal)

Entered Jun 25 1943. [29]

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[Title of Court and Cause.]

PETITION FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED  
STATES.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now United National Corporation, the pe-

itioner in this cause, by Roger L. Shidler, counsel for petitioner, and respectfully shows that:

## I.

The petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of Washington, with its principal office in Seattle, Washington. The income tax return of said corporation for the fiscal year ended June 30, 1939, was duly filed with the Collector of Internal Revenue for the District of Washington, which is within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

[30]

## II.

### The Nature of the Controversy.

The controversy involves the proper determination of the petitioner's liability for federal income tax for the fiscal year ended June 30, 1939.

The petitioner seeks to review only the second issue of the two decided by the Tax Court of the United States.

During the taxable year, Murphey, Favre & Co. redeemed 750 shares of its common stock, which was held by the petitioner and paid to petitioner, in connection with said redemption, \$176,746.55 in cash or property.

The Tax Court of the United States found and held that the distribution to petitioner, in connection with the liquidation of Murphey, Favre & Co., was made at such time and under such conditions as to make the distribution upon the cancellation or

redemption of the 750 shares of stock of Murphey, Favre & Co. essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code, to the extent of the accumulated earnings or profits. From this determination, the petitioner does not appeal.

The only issue left in the case for determination on appeal is the amount of the accumulated earnings or profits of Murphey, Favre & Co. on the date of the distribution, pursuant to the redemption of the 750 shares of stock. The facts on this issue as shown by the findings of the lower court are:

[31]

On June 30, 1929, Murphey, Favre & Co. redeemed shares of its preferred stock at a premium over par value in the total amount of \$30. On June 30, 1931, Murphey, Favre & Co. redeemed shares of its preferred stock at a discount from the par value of the shares in a total amount of \$19,588.90. On June 30, 1932, Murphey, Favre & Co. redeemed shares of its preferred stock at a discount from the par value of the shares in the total amount of \$830.10. All of the above redemptions were at a net discount of \$20,389. Upon redemption said shares were canceled or retired. Murphey, Favre & Co. never traded in its own stock by buying from one customer and selling to another. It was stipulated between the parties that if the Court found that the sum of \$20,389 representing the net discount on the redemption of the preferred stock is part of the accumulated earnings or profits of the



petitioner, then the amount of the accumulated earnings or profits of Murphey, Favre & Co. from February 28, 1913, to September 9, 1938, was \$108,509.80; and if the said sum of \$20,389 is not part of the accumulated earnings or profits of Murphey, Favre & Co., then the amount of the accumulated earnings or profits to September 9, 1938, was \$88,120.80 (the difference being \$20,389).

The respondent contended that the \$20,389, being the discount from par value on the redemption of the shares of Murphey, Favre & Co., was a part of the accumulated earnings or profits. The Tax Court of the United States sustained respondent's contention. The petitioner contends that the redemption of the preferred [32] stock was a capital transaction and that no part of the discount was a part of accumulated earnings or profits of Murphey, Favre & Co.

### III.

The petitioner, being aggrieved by the conclusions of law contained in the findings and opinion of the Tax Court of the United States and by its decision entered pursuant thereto, desires a review thereof by the United States Circuit Court of Appeals for the Ninth Circuit.

### IV.

#### Assignment of Error.

The petitioner assigns as error the following acts and omissions of the Tax Court of the United States:

1. The determination by the Tax Court of the



United States that the sum of \$20,389, representing the discount on the redemption of the preferred stock of Murphey, Favre & Co., was a part of the accumulated earnings or profits of Murphey, Favre & Co., and that petitioner received taxable income in any amount greater than \$88,120.80 upon the partial liquidation of Murphey, Favre & Co. on the redemption of 750 shares of common stock of Murphey, Favre & Co. held by petitioner.

ROGER L. SHIDLER

Counsel for Petitioner.

410 American Building,

Seattle 4, Washington. [33]

State of Washington

County of King—ss.

Roger L. Shidler, being first duly sworn, on his oath says:

That he is counsel of record in the above-entitled cause; that, as such counsel, he is authorized to verify the foregoing petition for review. That he has read the said petition and is familiar with the statements contained therein, and that the statements made are true to the best of his knowledge, information and belief.

ROGER L. SHIDLER

Subscribed and sworn to before me, this 11 day of August, 1943.

(Seal) MARIE K. LOMBARD

Notary Public in and for the State of Washington,  
residing at Seattle.

[Endorsed]: T. C. U. S. Filed Aug. 16, 1943. [34]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To General Counsel,

Bureau of Internal Revenue, Treasury Department,  
Washington, D. C.:

Please take notice that the petitioner, on the 16th day of August, 1943, filed with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above cause. A copy of the petition for review and the assignments of error, as filed, is hereto attached and served upon you.

Dated at Seattle, Washington, this 10th day of August, 1943.

(S) ROGER L. SHIDLER

Counsel for Petitioner,  
410 American Building,  
Seattle 4, Washington.

Service of a copy of the foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 16th day of August, 1943.

(S) J. P. WENCHEL

Chief Counsel,  
Bureau of Internal Revenue.

[Endorsed]: T. C. U. S. Filed Aug. 17, 1943. [35]

[Title of Court and Cause.]

STATEMENTS OF POINTS TO BE RELIED  
UPON ON APPEAL

Comes now the petitioner, United National Corporation, by its attorney, Roger L. Shidler, and designates the following as a statement of points intended to be relied upon by petitioner herein on appeal.

I.

That the sum of \$20,389, representing the net discount on the redemption in previous years of preferred stock of Murphey, Favre & Co., was no part of the accumulated earnings or profits of Murphey, Favre & Co. at the time of the partial liquidation of Murphey, Favre & Co. by the redemption of 750 shares of its stock held by petitioner.

ROGER L. SHIDLER

Attorney for Petitioner,  
410 American Building,  
Seattle 4, Washington.

[Endorsed]: T. C. U. S. Filed Aug. 16, 1943. [36]

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[Title of Court and Cause.]

PRAECIPE FOR RECORD

To the Clerk of the Tax Court of the United States:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Cir-

cuit Court of Appeals for the Ninth Circuit a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of the record the following documents or certified copies thereof, to-wit:

1. The docket entries of all proceedings before the Tax Court of the United States.

2. Pleadings before the Tax Court of the United States as follows:

(a) Petition for redetermination, and copy of notice of deficiency of tax.

(b) Answer to petition. [37]

3. The findings of fact and opinion of the Tax Court of the United States.

4. The decision of the Tax Court of the United States.

5. The petition for review filed by the petitioner in the above cause.

6. Statement of points to be relied upon by petitioner.

7. This praecipe.

ROGER L. SHIDLER

Counsel for Petitioner,  
410 American Building,  
Seattle 4, Washington.

Service of a copy of this praecipe is hereby acknowledged as of August 18, 1943.

(S) J. P. WENCHEL

Chief Counsel,  
Bureau of Internal Revenue.

[38]

[Title of Court and Cause.]

**CERTIFICATE OF CLERK TO TRANSCRIPT  
OF RECORD**

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 38, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeipie in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 8th day of September, 1943.

(Seal)

B. D. GAMBLE

Clerk, The Tax Court of the  
United States.

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[Endorsed]: No. 10556 United States Circuit Court of Appeals for the Ninth Circuit. United National Corporation, a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the Tax Court of the United States.

Filed September 20, 1943.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals  
for the Ninth Circuit

Docket No. 10556

UNITED NATIONAL CORPORATION,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

ADOPTION OF STATEMENT OF POINTS  
APPEARING IN THE TRANSCRIPT OF  
RECORD AS TO THE STATEMENT OF  
POINTS ON APPEAL.

Comes now the petitioner, United National Corporation, by its attorneys, Harroun & Shidler and Roger L. Shidler, and hereby adopts as the points on appeal the statement of points appearing in the transcript of the record.

HARROUN & SHIDLER and  
ROGER L. SHIDLER,  
Attorneys for Petitioner.

[Endorsed]: Filed Sept. 27, 1943. Paul P. O'Brien, Clerk.